83 - 1433

No. .....

In the Supreme Court of the United States

October Term, 1983

NORTHWEST PIPELINE CORPORATION,
C.P. NATIONAL CORPORATION,
COLORADO INTERSTATE GAS COMPANY,
CASCADE NATURAL GAS CORPORATION,
INTERMOUNTAIN GAS COMPANY,
NORTHWEST NATURAL GAS COMPANY,
MOUNTAIN FUEL SUPPLY COMPANY,
ROCKY MOUNTAIN NATURAL GAS CO., INC.,
SOUTHWEST GAS CORPORATION
and WASHINGTON NATURAL GAS COMPANY,
Petitioners,

v.

PHILLIPS PETROLEUM CO.,
AMOCO PRODUCTION CO., GETTY OIL CO.,
MOBIL OIL CORP., ATLANTIC RICHFIELD CO.,
CHAMPLIN PETROLEUM CO. and
T. H. McELVAIN, *et al.*,
Respondents.

PETITION FOR WRITS OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

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QUESTION PRESENTED

Whether the court of appeals substantially undercut *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954) ("*Phillips*"), and *United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965) ("*Rayne Field*"), which placed all interstate wholesales of natural gas, including in place sales by lease-sale, under regulation, by reversing the Federal Energy Regulatory Commission's assertion of Natural Gas Act jurisdiction over San Juan Basin lease-sales — forerunners of the *Rayne Field* lease-sales and, like them, the economic equivalent of regulated wellhead sales which "accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other States" — simply because the San Juan lease-sales required the interstate pipelines to perform most of the well development needed to deplete the natural gas from the transferred acreage.

LIST OF PARTIES

Public Agencies:

Federal

Federal Energy Regulatory Commission

State

People of the State of California
Public Utilities Commission of the State of California
Idaho Public Utilities Commission
Public Service Commission of Nevada
Public Utility Commissioner of Oregon
Washington Utilities & Transportation Commission
Public Service Commission of Wyoming

City

City of Ellensburg, Washington

Interstate Natural Gas Pipeline Companies:

El Paso Natural Gas Company
Northwest Pipeline Corporation

Distribution Companies:

Cascade Natural Gas Corporation
Colorado Interstate Gas Company
C.P. National Corporation
Intermountain Gas Company
Mountain Fuel Supply Company
Northwest Natural Gas Company
Pacific Gas and Electric Company
Rocky Mountain Natural Gas Company
San Diego Gas & Electric Company
Southern California Edison Company
Southern California Gas Company
Southern Union Company
Southwest Gas Corporation
Washington Natural Gas Company
Washington Water & Power Company

Producers:

El Paso's System	Party
GLA 47	Tenneco Oil Company
	Conoco, Inc.
GLA 51	Mapco, Inc.
	Hopi Oil Company
GLA 52	Tenneco Oil Company
	Conoco, Inc.
GLA 60	Tenneco Oil Company
	Conoco, Inc.
	Charles Colwill
	Anne Home Emerson, Trustee
	Anna Lou Home
	Jean E. Keyser
	Cassandra Keyser
	Teresa Home
	Barron Kidd
	Helen Ulmer van Atta
GLA 61	Sun Oil Company (Delaware)
GLA 62	FHN, Ltd.
GLA 63	Atlantic Richfield Company
GLA 66	W. Watson LaForce, Jr.
	Henry P. Isham, Jr. Estate
	Robert T. Isham
	Josephine C. Jacobson
	J. Roberts Jones
	Nancy LaForce Keyes
	Frederic P. G. Lattner, Trustee, U/T Martha M. Lattner, Settlor
	Suzanne LaForce Baber
	James C. Bard
	Douglas N. Bard
	Ralph A. Bard, Jr.
	Roy E. Bard, Jr.
	G. Brainard, Jr. Trust
	Continental Illinois National Bank and Trust Company, Trustee Trust No. 23935

El Paso's System	Party
	Continental Illinois National Bank and Trust Company, Trustee Trust No. 23949
	Eleanor Isham Dunne
	Charles W. Farnham, Jr.
	Robert B. Farnham
	Walter B. Farnham
	Elizabeth B. Farrington
	Minnie A. Fitting
	R. U. Fitting, Jr. Estate
	Robert D. Fitting
	Nancy H. Gerson
	John R. Grimes
	Ruth N. Halls
	Cortland T. Hill
	Elsie F. Hill
	Louis W. Hill, Jr.
	Albert L. Hopkins, Jr.
	George S. Isham
	R. S. MacDonald, A. MacDonald and Northern Trust Co., Trustees U/W of N.S. MacDonald, Deceased
	Mary F. Love
	William J. McDermott, Trustee
	Nora R. Ranney
	Catherine H. Ruml
	Edward L. Ryerson, Jr.
	Sabine Royalty Corporation
	Shaw, Isham & Company
	John I. Shaw, et al., Trustee
	James Simpson, Jr. Trust
	William E. Simpson Trust
	Sydney Stein, Jr.
	Northern Trust Co., Trustee, U/W of John Stuart
	Robert Douglas Stuart Estate
	William P. Sutter
	Michael Simpson Trust
	Patricia Simpson Trust
	Katharine I. White

El Paso's System	Party
	Kay B. Gundlach
	Frederick F. Webster Trust
	Mary S. Zick
	David Waller Dangler
GLA 72	Mapco, Inc.
	Hopi Oil Company
GLA 76	Union Oil Company of California
	First National Bank of Ft. Worth, Trustee for Eula May Johnston
	James J. Johnston
	V. A. Johnston Family Trust
	Jones Company
	Wm. C. McMahan Estate
	Homer R. Stasney & Sons Company
	Rogers-Gibbard Trust
GLA 77	Robert Beamon
	Robert Beamon, Trustee
	Pattie Ann Beamon Lundell
	Thomas L. Hall, Trustee
GLA 78	American Petrofina Company
	Tenneco Oil Company
	Conoco, Inc.
GLA 86, 101, 127	Mapco, Inc.
	Hopi Oil Company
GLA 106	Morris and Flora Mizel
GLA 122	Producing Royalties, Inc.
	Harold S. Long
	Dixie M. McLane, Trust
	Mrs. Judy St. John Taylor
	John S. White
GLA 125	American Petrofina Company
	Anderson Construction Company, Inc.
	Benson-Montin-Greer Drilling Corp.
	Tom Bolack
	Oliver Benson
	Albert R. Greer
	Mary Eddy Jones

El Paso's System	Party
	Edna Fern Benson
	Walter Benson
	Charlene K. Greer
	Mary E. Jones and The First National Bank & Trust Company of Oklahoma City, Trustees U/W of F. Jones
	Late Oil Company
	A.C.Montin, Jr.
	William V. Montin
	Oklahoma and Northwestern Company
GLA 129	Delta Drilling Company
	Trustees of the DeGolyer Foundation
	Mrs. Nell V. DeGolyer
GLA 139	Producing Royalties, Inc.
	James A. and Hazel H. Borland
	R. Lewis Chandler Trust
	Marcy C. Fannin
	Charles E. Graham, Jr.
	Newell R. Hays
	Dixie M. McLane Grandchildren's Trust
	Critchell Parsons
	Judy St. John Taylor
GLA 152, 160, 231	J. Glenn Turner
	Sue Reeder Turner Trust
	William G. Webb
GLA 153	Gretchen A. Gartner
	Helen L. Harvey
GLA 157	Mapco, Inc.
	Barbara Ann Bruss
	O. J. Lilly
	Barbara Irene McConnell
GLA 172	Crown Central Petroleum Corporation
GLA 195	William G. Webb
GLA 196	J. Glenn Turner
	Sue Reeder Turner Trust
	William G. Webb
	Benson-Montin-Greer Drilling Corp.

El Paso's System	Party
	Barbara Ann Bruss
	Charles Albert Greer
	La Plata Gathering System, Inc.
	O. J. Lilly
	Huerfanito Gas Co., et al., PP
	Barbara Irene McConnell
	Mary R. Boecking and H. E. Boecking, Jr., Trustees
	Jacqulyn M. Williams
GLA 197	Huerfanito Drilling Company, Inc.
GLA 198, 248	J. Glenn Turner
	Sue Reeder Turner Trust
	William G. Webb
	Frank A. Schultz
GLA 249	Benson-Montin-Greer Drilling Corp.
	Barbara Ann Bruss
	Charles Albert Greer
	La Plata Gathering System, Inc.
	O. J. Lilly
	Barbara Irene McConnell
	Mary R. Boecking and H. E. Boecking, Jr. Trustees, U/T of Mary M. Strachley
	J. Glenn Turner
	Sue Reeder Turner Trust
	Jacqulyn M. Williams
GLA 348	Union Oil Company of California
	Jones Company
	W. C. McMahan
	H. R. Stasney & Sons Company
GLA 349	Union Oil Company of California
GLA 350, 351	Robert Beamon
	Robert Beamon, Trustee
	Thomas L. Hail, Trustee
	Pattie Ann Beamon Lundell

Northwest's System	Party
PLA 2	Atlantic Richfield Company
PLA 3	Getty Oil Company
PLA 4	Grace M. Brown
	Catherine B. McElvain, Inc. and as Executive of Estate of T. H. McElvain, Deceased
	T. H. McElvain Oil and Gas Properties
	James E. McElvain, Executor of Estate of Carl R. McElvain
	J. Wm. McElvain
	Estate of F. B. Miller
	Mabelle McElvain Miller
	Mrs. Ruth M. Vaughn
PLA 5	Phillips Petroleum Company
PLA 6	Amoco Production Company
	J. Ralph Ellis, Jr.
	Jones Felvey, II
	First National Bank in Dallas for the Acct. of J. Ralph Ellis, Jr.
	McCulloch Oil Corporation
	Mountain States Natural Gas Corp.
	John D. Mugg, Jr.
	Jack B. Ryan
	Texas Oil & Gas Corp.
	U. V. Industries
PLAs 7, 9, 10, 11	Amoco Production Company
PLA 8	J. Ralph Ellis, Jr.
	Jones Felvey, II
	First National Bank in Dallas for the Acct. of J. Ralph Ellis, Jr.
	H. M. Meredity Trustee and First National Bank of J. Ralph Ellis, Jr.
	Mountain States Natural Gas Corp.
	John D. Mugg, Jr.
	Amoco Production Company
	Jack B. Ryan
	Texas Oil & Gas Corp.
PLA 13	Mobil Oil Corporation
PLA 14	Champlin Petroleum Co.

LIST OF PETITIONERS' PARENTS, SUBSIDIARIES AND AFFILIATES PURSUANT TO RULE 28.1

Petitioner Northwest Pipeline Corporation

The Williams Companies
Agrico Chemical Company
Agrico Fertilizer Company
Agrico International Company
Agrico Mining Company
Agrico Overseas Company, S.A.
Agrico Overseas Investment Corporation
Agrico Retail Company
Edgcomb Metals Company
Williams Exploration Company
Williams Natural Gas Company
Williams Pipeline Company
Williams Realty Company
Northwest Energy Company
Pacific Northwest Realty Corporation
Phillips Pacific Chemical Company
Prairie Pipe Lines Limited (inactive)
Prairie Transmission Lines Limited (inactive)
Trans-Intermountain Gas & Energy Resources Company
Applied Science, Inc.
F T & T, Inc.
Northwest Alaska Company
Northwest Alaskan Pipeline Company
Northwest Border Pipeline Company
Northwest Coal Corporation
Western Slope Carbon, Inc.
Northwest Exploration Company
Northwest Canada Exploration Company
Northwest Land Company
Northwest International Company
Northwest Ecuador Company
Northwest Guayaquil Company
Northwest Radio Broadcasting Company
Northwest Technical Services Company
SS Properties Incorporated
Marker International
NGL Production Company
Northwest Argentina Corporation
Northwest Canadian Gas Sales Company
Northwest Carbon Corporation
Northwest Investment Incorporated
Northwest Trading Company
Inner Ocean Services, Inc.

Petitioner Cascade Natural Gas Company

Cascade Land Leasing Company
Cascade Building Company

Petitioner Colorado Interstate Gas Company

ABCO Aviation, Inc.
ABCO Leasing, Inc.
The Belcher Company of New York, Inc.
The Belcher Company of Tennessee, Inc.
Belcher New England, Inc.
Belcher New Jersey, Inc.
Belcher Oil Company
Belcher Terminals, Inc.
Belcher Towing Company
Belgische Petroleum Raffinaderij N.V.
Border Exploration Company
CIC Industries, Inc.
CIG-Canyon Compression Company
CIG Exploration, Inc.
CIG Gas Supply Company
CIG Overthrust, Inc.
Coastal (Bermuda) Limited
Coastal Capital Corporation
Coastal Coal Sales Company
Coastal Congo Exploration Limited
The Coastal Corporation
Coastal Energy Corporation
Coastal Finance Corporation
Coastal Financial Antilles N.V.
Coastal Financial B.V.
Coastal Hercules, Inc.
Coastal Libya Exploration Limited
Coastal Libya, Inc.
Coastal Limited Ventures, Inc.
Coastal Management Services (Singapore) Pte. Ltd.
Coastal Netherlands Financial B.V.
Coastal Offshore Insurance Ltd.
Coastal Oil & Gas Corporation
Coastal Papua New Guinea Exploration, Inc.
Coastal Petroleum (Far East) Pte. Ltd.
Coastal Refinery Marketing B.V.
Coastal Refining Company
Coastal States Crude Gathering Company
Coastal States Energy Company
Coastal States Europe Limited

Coastal States Exploration Services Limited
Coastal States Management Corporation
Coastal States Marketing, Inc.
Coastal States Petroleum Company
Coastal States Petroleum (U.K.) Limited
Coastal States Trading, Inc.
Coastal States Trading (U.K.) Limited
Coastal Uranium, Inc.
Coastal Ventures, Inc.
Cody Gas Company (Division)
Colbourne Insurance Company Limited
Colorado Interstate Corporation
Cosbel Petroleum Corporation
Coscol Marine Corporation
Coscol Petroleum Corporation
Costa Petro
Derby Refining Company
Freeburn Corporation
Geogas Enterprise S.A.
Holborn Oil Company Limited
Holborn Oil Trading Limited
Holborn Petroleum S.A.
Holborn-Pomona Petroleum Limited
Jayhawk Pipeline Corporation
Manatee Towing Company
McCoy Caney Coal Company
Pacific Refining Company
Pomona Shipping Company
Pomona Shipping Company Limited
Southern Utah Fuel Company
Stonehurst Limited
Subtype Limited
Succula Limited
Texas Tank Ship Agency, Inc.
Texcol Gas Services, Inc.
Utah Fuel Company
Western Fuel Oil Company
Woodstock Shipping Company
Woodstock Shipping Company Limited
Wycon Chemical Company
Wyoming Gas Supply, Inc.

Petitioner Intermountain Gas Company

Intermountain Gas Industries, Inc.
Interex, Inc.

I.G.C. Production Company
I.G.C. Properties, Inc.

Petitioner Mountain Fuel Supply Company

Mountain Fuel Resources, Inc.

Petitioner Northwest Natural Gas Company

Northwest Geothermal Corporation
Northwest Natural Gas Finance, N.V.
Oregon N.G. Development Corporation
Pacific Square Corporation

Petitioner Rocky Mountain Natural Gas Company

Gasco, Inc.
RMNG Gathering Co.

Petitioner Southwest Gas Corporation

Utility Financial Corporation
Carson Water Company
Southwest Gas Corporation of Arizona
Don A. Harris and Associates, Inc.
Design Center Southwest
Southwest Companies
Pataya Storage Company
Southwest Administrators

Petitioner Washington Natural Gas Company

Washington Energy Company

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No. .....

In the Supreme Court of the United States

October Term, 1983

NORTHWEST PIPELINE CORPORATION,
C.P. NATIONAL CORPORATION,
COLORADO INTERSTATE GAS COMPANY,
CASCADE NATURAL GAS CORPORATION,
INTERMOUNTAIN GAS COMPANY,
NORTHWEST NATURAL GAS COMPANY,
MOUNTAIN FUEL SUPPLY COMPANY,
ROCKY MOUNTAIN NATURAL GAS CO., INC.,
SOUTHWEST GAS CORPORATION
and WASHINGTON NATURAL GAS COMPANY,
Petitioners,

v.

PHILLIPS PETROLEUM CO.,
AMOCO PRODUCTION CO., GETTY OIL CO.,
MOBIL OIL CORP., ATLANTIC RICHFIELD CO.,
CHAMPLIN PETROLEUM CO. and
T. H. McELVAIN, *et al.*,
Respondents.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioner Northwest Pipeline Corporation ("Northwest"), a major western supplier of natural gas through its interstate pipeline system extending from the San Juan Basin of New Mexico and Colorado to the Pacific Northwest, and petitioners C.P. National Corporation, Colorado Interstate Gas Company, Cascade Natural Gas Corporation, Intermountain Gas Company, Northwest Natural Gas Company, Mountain Fuel Supply Company, Rocky Mountain Natural Gas Co., Inc., Southwest Gas Corporation and Washington Natural Gas Company, companies which purchase natural gas from Northwest for resale to consumers in seven western states (hereinafter collectively "Northwest and its customers"), respectfully pray that Writs of Certiorari issue to review the judgments of the United States Court of Appeals for the Fifth Circuit (former Fifth), entered on July 5, 1983, in *El Paso Natural Gas Co. v. Sun Oil Co.*, No. 77-1762, and *Tenneco Oil Co. v. FERC*, No. 80-2404.

OPINIONS BELOW

The opinion of the court of appeals, *El Paso Natural Gas Co. v. Sun Oil Co.*, 708 F.2d 1011 (5th Cir. 1983), is reproduced at Appendix 1a-19a ("App."),[1] and its judgments are reproduced at App. 145a and 149a. An unreported order, dated December 2, 1983, denying petitions for rehearing and suggestions of rehearing en banc is reproduced at App. 151a.

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[1] Citations are to the separate Appendix filed on February 9, 1984, by by petitioners in People of the State of California, et al. v. Tenneco Oil Co., et al., Docket No. 83-1231, which contains the judgments below and all judical and administrative opinions in this matter.

The Fifth Circuit reversed a decision of the Federal Energy Regulatory Commission (the "FERC" or the "Commission" [2]) (No. 80-2404) and affirmed a decision of a federal district court (No. 77-1762). The Initial Decision of the FERC Administrative Law Judge (ALJ), *El Paso Natural Gas Co.*, 6 F.E.R.C. ¶ 63,037 (1979), is reproduced at App. 33a-120a. The Commission's Order Affirming Initial Decision and Initiating Further Hearing, *El Paso Natural Gas Co.*, 12 F.E.R.C. ¶ 61,296 (1980), is reproduced at App. 21a-31a, and its Order Denying Applications for Rehearing, 13 F.E.R.C. ¶ 61,239 (1980), is reproduced at App. 153a. The decision of the district court, *El Paso Natural Gas Co. v. Sun Oil Co.*, 426 F.Supp. 963 (W.D. Tex. 1977), is reproduced at App. 121a-136a. The Fifth Circuit's decision in 1978, deferring action on appeals from the district court and on petitions for review of the Commission's authority to institute an investigation pending completion of the FERC proceedings, *Tenneco Oil Co. v. FERC*, 580 F.2d 722 (5th Cir. 1978), is reproduced at App. 137a-141a.

JURISDICTION

1. The court of appeals held that lease-sale transfers of large volumes of proven reserves in the San Juan Basin were not sales for resale under §1(b) of the Natural Gas Act (NGA), 15 U.S.C. § 717(b). It reversed an FERC determination that the transfers were jurisdictional sales under § 1(b) (No. 80-2404), and affirmed an earlier contrary federal district court decision relating

[2] Prior to 1977, "Commission" refers to the Federal Power Commission ("FPC").

to some of the transfers (No. 77-1762). The Commission had jurisdiction under §§ 4, 5, 7, 8, 14 & 16 of the NGA, 15 U.S.C. §§ 717c, d, f, g, m & o. The district court's jurisdiction rested on 28 U.S.C. § 1331 and § 22 of the NGA, 15 U.S.C. § 717u.

2. The court of appeals entered its judgments on July 5, 1983, and denied rehearing on December 2, 1983. This Petition for Writs of Certiorari is timely under 28 U.S.C. § 2101(c). This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1) and § 19(b) of the NGA, 15 U.S.C. § 717r(b).

FEDERAL STATUTE INVOLVED

Section 1(b) of the NGA, 15 U.S.C. § 717(b), provides:

> The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption or domestic, commercial, industrial, or any other use, and to natural gas companies engaged in such transportaton or sale, but shall not apply to any other transportation or sale of natural gas or to the local disribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

STATEMENT OF THE CASE

This Petition for Writs of Certiorari seeks review of the court of appeals' unprecedented and erroneous reversal of the Commission's assertion of NGA jurisdiction over certain lease-sale agreements. Under these agree-

ments two major interstate pipelines, Northwest and El Paso Natural Gas Company ("El Paso"), for nearly thirty years have produced large volumes of natural gas for the western interstate market from hundreds of wells in the San Juan Basin of northwest New Mexico and southwest Colorado. At issue is the jurisdictional status under the NGA of twelve lease-sale agreements held by Northwest, called Pacific Lease Agreements ("PLAs"), and thirty-five lease-sale agreements held by El Paso, called Gas Lease Agreements ("GLAs"), which together transferred trillions of cubic feet of proven natural gas reserves and cover more than half of the over one million acres in the San Juan Basin.

Neither the opinion of the court of appeals nor that of the district court described the controlling facts of the PLAs. Only the Initial Decision of the ALJ, adopted by the Commission, sets forth their crucial history, 6 F.E.R.C. ¶ 63,037, at 65,208-211 (App. 74a-86a). In summary, that history shows:

1. *The PLA Properties and Agreements*

The Pacific Northwest—Oregon, Washington and Idaho—with northern Nevada was one of the last major areas in the continental United States to obtain natural gas service. In 1950, Pacific Northwest Pipeline Corporation ("PNW"), Northwest's predecessor, was organized as a promotional venture dependent on project financing to construct and operate an extensive new interstate pipeline system to bring natural gas service to this large area. The required gas supply was found in the San Juan Basin, one of the largest dry natural gas fields in North

America. Underlying most of the Basin are three gas bearing, blanket sandstone formations: the shallow Pictured Cliffs, the massive Mesaverde and the Dakota. By 1950, this extensive Basin had commercial production from a number of Picture Cliff and Mesaverde wells, which could be drilled in a few weeks for about $40,000 and less than $80,000, respectively, and was recognized as a major source of natural gas ripe for large scale commercial development. The impetus for such development came in 1950, when the Commission authorized El Paso to transport San Juan Basin gas to California. Much of this gas for the California market was obtained by El Paso from San Juan producers under the GLAs.

In 1952 PNW filed an application for a Commission certificate to build a pipeline from the San Juan Basin to the Pacific Northwest market. The principal gas supply contracted for the new PNW system came from the Mesaverde and Pictured Cliffs formations through the PLAs into which PNW entered with seven San Juan Basin natural gas producers. Because PNW, as a promotional venture, then existed only on paper, its acquisition of this gas supply was expressly conditioned on PNW obtaining project financing to construct its proposed system and on Commission certification. Both Commission certification and the availability of financing, in turn, were dependent on proof satisfactory to the Commission and to lenders that the properties covered by the PLAs would supply sufficient gas reserves capable of imminent delivery to support PNW's proposed new gas service to the Pacific Northwest. *See Northwest Natural Gas Co.*, 13 F.P.C. 221, 239 (1954).

To acquire the needed reserves, PNW had to offer the San Juan producers an option under which PNW would either purchase their gas at the wellhead or acquire their reserves in place through a sale of leases. Under the wellhead sale (Option I), PNW offered to pay $.12 per thousand cubic feet (Mcf) of natural gas for the first five years, the price to escalate in $.01 increments for each succeeding five year period. Under the in place lease-sale (Option II), which became the format for the PLAs, PNW offered to pay an escalating "special overriding royalty" [3] on each Mcf of gas produced: $.07 per Mcf for the first three and one-third years, escalating incrementally through the twelfth year, and thereafter redetermined at prevailing wellhead market value if greater than the agreed price as determined under the escalation formula. The $.05 per Mcf difference between Option I and Option II reflected the anticipated development drilling and production costs that would be incurred under Option I by the San Juan producers or by PNW under Option II. Thus, the San Juan producers would receive as much or more net income for their gas reserves under a lease-sale transfer as they would under a conventional wellhead sale and would be relieved of development and production responsibilities. Through this option proposal, PNW acquired conditional natural gas "commitments" from respondent Phillips Petroleum Company ("Phillips") and the predecessors of respondents

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[3] The "special overriding royalty" is a payment to the producers in cents per Mcf on the net interest gas volume (total gas volume less the 12½% landowner royalty and any other fractional overriding royalty — typically 5% or less) so that the special overriding royalty is payable on about 80% of the total PLA gas volumes.

Amoco Production Company, Getty Oil Company, Atlantic Richfield Company, Mobil Oil Corporation and Champlin Petroleum Company.

Phillips, then the nation's largest producer of natural gas, held leases on major portions of the San Juan Basin. In June 1952, Phillips and PNW signed an agreement committing Phillips' San Juan gas reserves to PNW under Option I or II as Phillips later might elect and Phillips initiated an extensive drilling program so that its reserves could be evaluated. In January 1953, Phillips selected Option II and executed with PNW a *conditional* assignment which committed Phillips to complete a drilling program that would establish the presence of at least 2.5 trillion cubic feet (Tcf) of proven reserves under its San Juan Basin acreage. This lease-sale agreement, which became known as "PLA-5", covered approximately 200,000 acres and was conditioned on PNW's financing and certification. It established the pattern for the lease-sale agreements PNW later executed with other San Juan producers to acquire its gas reserves. The evidence below showed that the PLA and GLA San Juan producers, like the producers involved in the *Rayne Field* lease-sales, chose to sell their reserves in place under a lease-sale rather than at the wellhead in the belief that they thus would avoid price regulation under the NGA. App. 49a-50a, 59a-60a, 105a.

2. *PLA Reserve Evaluations and PNW Certification*

In 1953, with these San Juan Basin reserves conditionally committed to PNW under the PLAs and the

producers drilling wells where necsesary for an extensive reserve evaluation, PNW commissioned the engineering firm, DeGolyer & McNaughton ("D&M"), to evaluate the magnitude and availability of the PLA reserves so that the reserves could be used by PNW to obtain a Commission certificate and as collateral for PNW's financing. In July 1953, D&M issued a detailed study that determined that 196,000 PLA acres were then proven for production, containing an estimated 3.06 trillion cubic feet (Tcf) of gas reserves with 2.44 Tcf allocated to the Phillips PLA-5 acreage alone.

In June 1954, the Commission granted PNW a certificate to build its proposed 1200-mile pipeline system from the San Juan Basin to the Pacific Northwest conditioned upon PNW's obtaining satisfactory financing to complete construction, estimated to cost $160 million. The Commission relied on D&M's estimate that PNW had commitments of approximately 3 Tcf underlying 196,000 PLA acres, 13 F.P.C. at 229-230, and also on testimony by a Phillips engineer who estimated proven recoverable PLA reserves committed to PNW at a level even higher than D&M. *Id.* at 239. The Commission specifically found that D&M's estimates of gas reserves reflected "careful study of the fields and the estimates [were] reliable." *Id.* at 230.

PNW continued to acquire reserves in the San Juan Basin[4] and other producing areas to provide additional

[4] In January 1955, PNW entered into a lease-sale agreement (PLA-4) with respondent T. H. McElvain. Like all but one of the other PLAs, PLA-4 did not close until later in 1955, after PNW obtained its certification and financing.

collateral for project financing. To provide lenders and investors further assurance that adequate gas supplies were available to support the construction of its system, PNW commissioned the engineering firm, Brokaw-Dixon, to prepare another report evaluating all of PNW's committed reserves. In reliance on the Brokaw-Dixon and D&M reports, lenders and investors committed $160 million, secured by the PLA gas reserves, to construct the PNW pipeline system.

In February 1955, the Commission approved PNW's financing plan. That approval made PNW's certificate final thus finally satisfying the conditions of the PLAs so that they could close. However, documents transferring the PLA reserves to PNW were not executed and delivered until May 4, 1955, when PNW actually obtained the necessary funds from lenders and investors to pay the San Juan producers some $7.5 million for existing wells and equipment. There were then 124 gross (79.708 net) wells on or communitized with the PLA acreage from which the producers had already made jurisdictional wellhead sales of substantial gas volumes.[5] Expeditious development drilling and ultimately complete well development by PNW was required under each PLA. These drilling requirements and other contractual obligations which made PNW produce most of its market supply from the San Juan Basin assured the PLA producers of rapid development of their properties and of

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[5] PLA-5 was the largest of the PLAs. There were 75 producing wells when the PLA-5 acreage was finally transferred to PNW in May 1955. During 1954, Phillips made jurisdictional sales of 1.35 billion cubic feet (Bcf) from these wells to existing pipelines.

substantial, continuous special overriding royalty payments.[6]

PNW's new pipeline system was quickly constructed, inaugurating interstate service from the San Juan Basin on September 1, 1956, to the gas consumers of the Pacific Northwest. During the first twelve month period after the reserves were transferred, the PLA acreage produced 12.6 billion cubic feet (Bcf) of gas for the interstate market . During 1957, the first full calendar year that the PNW system was in operation, PNW produced over 30 Bcf from the PLA acreage as the principal supply for the system.[7] Similar annual volumes have been produced ever since and are expected to be produced for many years to come. It is estimated that at least one trillion cubic feet of PLA gas reserves will be produced in the future.[8]

3. *The Overriding Royalty Litigation*

El Paso acquired the PLAs in 1957 when it acquired PNW. From the 1950s through 1973, the special overriding royalty paid the PLA and GLA producers gradu-

[6] Under PLA-5, PNW had to drill 250 net wells by July 1, 1955 and take 350 million cubic feet (MMcf) per day from the San Juan Basin which was actually a little more gas than the initial design capacity of the new pipeline. See App. 77a.

[7] In April 1957, after its pipeline had been completed and operational, PNW executed the final lease-sale agreement at issue, PLA-13, with a predecessor of respondent Mobil Oil Corporation under which approxmately 13,000 acres in the San Juan Basin were transferred to PNW. On the date PLA-13 closed, there were two wells on the acreage and gas volumes from that acreage had been flowing in interstate commerce via the PNW pipeline for seven months.

[8] As a frame of reference annual natural gas consumption for the entire United States currently equals about 20 Tcf.

ally increased to $.10 per Mcf. In 1973, however, Sun Oil Company ("Sun"), one of El Paso's GLA owners, demanded that the special overriding royalty be calculated on the market value of the gas. El Paso's rejection of that demand led to an arbitration award to Sun of a special overriding royalty of $.40 per Mcf. This price was based upon the wellhead value of gas in the unregulated intrastate market and was substantially above that allowed by the Commission for comparable vintage gas under the NGA.

In 1973, El Paso filed suit in federal court against Sun and the other San Juan producers who had sought equivalent treatment, claiming that the San Juan lease sales in the 1950's had been, in economic effect, wholesales of gas for resale in interstate commerce, and hence, under *Rayne Field*, were subject to the Commission's jurisdiction under the NGA. Northwest, which in early 1974 acquired the PLAs upon this Court's ordered divestiture from El Paso, intervened in the litigation that included PLA-13, held by Mobil. El Paso also filed a complaint with the Commission which requested that it determine the jurisdictional status of the PLAs and GLAs. Northwest filed a similar Commission complaint covering all the PLAs and its customers and the public utilities commissions of several of the states served by them intervened in this proceeding.

The pipelines moved the district court to refer the jurisdictional issue to the Commission under the primary jurisdiction doctrine. However, the court carried the motion with the case and denied it by implication when, in

1977, it held that the GLAs and the one PLA before the court were not jurisdictional. App. 121a-136a.[9]

After the district court's decision, the Commission, which was not a party to the district court action, initiated its own consolidated investigation into the jurisdictional status of all of the PLAs and GLAs. Following a lengthy evidentiary hearing, principally concerning the eleven PLAs absent from the district court trial and the consideration of the complete district court record, the ALJ issued a comprehensive opinion in 1979 holding all of the PLA and GLA lease-sale transfers jurisdictional under *Rayne Field*. In 1980, the Commission, adopting the ALJ's decision, affirmed and ordered the initiation of a remedy proceeding to determine what regulatory relief should be required as to the PLAs and GLAs.

In July 1983, the Fifth Circuit reversed the Commission's decision. Calling the issue "difficult to decide", App. 11a, the court did not dispute the Commission's conclusions (1) that the PLA and GLA lease-sale transactions were, in economic effect, equivalent to conventional wellhead sales; (2) that the PLA and GLA reserves were proven and that the transfer of the reserves to the pipelines was for the purpose of interstate transmission and resale; and (3) that soon after transfer of the reserves to the pipelines, great quantities of natural gas were flowing from the PLA and GLA properties to gas consumers in the Pacific Northwest and California. *See* App. 12a, 15a.

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[9] Only the jurisdictional status of PLA-13, the last PLA obtained, was litigated because the district court denied Northwest's motion to join the owners of the other PLAs.

The court reversed the Commission on the narrow ground that the PLA and GLA properties were not substantially developed (in terms of the number of wells drilled) when the agreements were initially signed because the number of development wells sufficient to substantially deplete the acreage had not yet been drilled by the producers. The court justified this "reserve depletion" or "extensive development" requirement for jurisdictional sales on language used by this Court in *Rayne Field* to describe that acreage: "a proven and substantially developed field." 381 U.S. at 401. The court reached its conclusion essentially by counting the number of development wells on the PLA properties when the initial option agreements were first executed which was before the PLA producers had even commenced their drilling programs *and years before the PLA conditions were met and the reserves were actually transferred. See* App. 15a-17a.

Petitions for rehearing and suggestions of rehearing en banc filed by the FERC, the pipelines, the pipelines' customers and six western state commissions were denied on December 2, 1983. App. 152a.

REASONS FOR GRANTING THE WRITS

The court of appeals' decision misapplies the teachings of this Court and deprives the pipelines, their customers and western gas consumers of the regulatory protection to which they are entitled under the NGA. Relying for its restricted view of the scope of Commission jurisdiction over lease-sale transfers on this Court's 1949 construction of the "production or gathering" exemption

of § 1(b) in *FPC v. Panhandle Eastern Pipeline Co.*, 337 U.S. 498 (1949), the court of appeals misread this Court's more recent and expansive construction of Commission jurisdiction in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), and *Rayne Field*, which placed all interstate wholesales of natural gas, including in place sales by lease-sale, under regulation.

The lower court's conclusion that a producer must have drilled most of the development wells needed to deplete the acreage before a lease-sale transfer of the reserves can be jurisdictional is also irreconcilable with Judge Wisdom's long standing decision for the Fifth Circuit in *Ship Shoal* (*Continental Oil Co. v. FPC*, 370 F.2d 57 (5th Cir. 1966), *cert. denied*, 388 U.S. 910 (1967)). Moreover, the lower court ignored the economic realities of a lease-sale transfer of proven reserves in new gas fields or in new extensions of producing fields to an interstate pipeline. Further compounding its error, the lower court chose the wrong point in time — the date of the conditional execution of the PLA agreements, rather than the date of the transfer of the reserves — to assess the economic realities of the transactions.

The erroneous decision below imposes substantial economic injury on the gas consumers in eight western states served by Northwest and El Paso. From 1974 through 1982, gas consumers in Northwest's market area were forced to pay, through Northwest's regulated cost of service, some $130 million more (by Northwest's estimate and exclusive of interest) to the PLA producers than they should have paid had the special overriding

royalties been subject to federal price regulation.[10] Unless the Fifth Circuit's decision is reversed, western gas consumers will have no remedy for the large overcharges they have paid to the respondent producers. Of equal concern, Northwest, its customers and their ultimate consumers also face potentially enforceable special overriding royalty demands from the PLA producers greatly exceeding the regulated ceiling prices for future PLA production. Northwest's market has already been severely impacted by high gas prices. Excessive future prices for PLA gas, one of Northwest's principal domestic gas supplies, will only further exacerbate that market disruption.

There is exceptional public importance here: the decision below wrongly restricts the scope of Commission jurisdiction under the NGA, deprives millions of western gas consumers of the regulatory protection to which they are entitled, denies them a remedy for large past overcharges and threatens them with continuing substantial overcharges in the future.[11]

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[10] Northwest, its customers, the state commissions in its market area and the FERC staff were attempting to recover these substantial overpayments which have been made under protest and subject to refund, for the benefit of gas consumers in the remedy phase of the Commission's proceedings when those proceedings were suspended due to the Fifth Circuit's decision.

[11] In an effort to minimize the serious economic consequences of the lower court's decision, Northwest recently concluded a settlement with Phillips to control the future cost of PLA-5 production. This settlement provides that if this Court reverses the court of appeals and affirms the Commission's jurisdiction over the overriding royalties, Phillips will pay a compromised, but still very substantial, refund and be subject to a possible reduction in the negotiated future special overriding royalty payment level.

THE DECISION BELOW IGNORES THE TEACHINGS OF THIS COURT IN *PHILLIPS* AND *RAYNE FIELD* THAT ALL WHOLESALES OF NATURAL GAS, INCLUDING ECONOMICALLY EQUIVALENT LEASE-SALE TRANSFERS, ARE TO BE REGULATED FOR THE PROTECTION OF THE CONSUMER.

In reaching its erroneous holding that the Commission lacked jurisdiction over the PLA lease-sales, the court of appeals criticized "the Commission's economic equivalency/commercial realities approach", App. 19a, in disregard of the teaching of this Court's two leading cases: *Phillips* and *Rayne Field*. In *Phillips*, this Court held that the Commission had jurisdiction under § 1(b) to regulate the rates charged by producers in wellhead sales to interstate pipelines for resale in interstate commerce. This Court in *Phillips* rejected the producers' contention that wellhead sales were excluded from Commission jurisdiction by the "production or gathering" exemption of § 1(b), and it emphasized that "exceptions to the primary grant of jurisdiction in the section [1(b)] are to be strictly construed, . . ." 347 U.S. at 679 (quoting *Interstate Natural Gas Co. v. FPC*, 331 U.S. 682, 690-91 (1947)). The Court stressed that Congress intended "to give the Commission jurisdiction over the rates of *all wholesales* of natural gas in interstate commerce, . . ." 347 U.S. at 682 (emphasis added).

Eleven years later, in *Rayne Field*, this Court reaffirmed that holding. Like this case, *Rayne Field* arose out of an attempt by producers to avoid regulation under

the NGA by selling gas reserves in place through the form of a lease-sale transaction rather than selling gas at the wellhead. The form was similar to that of the PLAs and GLAs and, like these San Juan Basin producers, the Rayne Field producers contended that under *FPC v. Panhandle Eastern Pipeline Co., supra,* a lease-sale of gas in place was beyond the scope of Commission jurisdiction regardless of the economic substance of the transaction. But the Court in *Rayne Field* limited *Panhandle* to its facts, 381 U.S. at 403-04, and held that a functional analysis of the economic substance of lease-sale transactions must be undertaken. Where lease-sales are "in most respects, equivalent to conventional sales of natural gas", *id.* at 401, and the "significant and determinative economic fact" is that the lease-sales "accomplish[ ] the transfer of large amounts of natural gas to an interstate pipeline company for resale in other States," *id.*, Commission jurisdiction must attach. A contrary result, the Court concluded, would "substantially undercut *Phillips*", *id.*, and deprive consumers of the "protection . . . against exploitation at the hands of natural gas companies that was the primary aim of the Natural Gas Act." *Id.* at 402 (quoting *Phillips*, 347 U.S. at 682).

The decision below defeats that "primary aim" and undercuts both *Phillips* and *Rayne Field.* The court below did not dispute the Commission's findings that the PLA and GLA lease-sales were the economic equivalent of ordinary wellhead sales, that the transfers of reserves to El Paso and Northwest were for the purpose of interstate transmission for resale and that the reserves were proven within reasonable estimates at the time of trans-

fer. Nevertheless, by simply counting the number of development wells on the various leases at the time the agreements were signed — between one and two years before the actual transfer of the PLA reserves — the court concluded that the reserves were not substantially developed like the *Rayne Field* reserves and thus the transfer of these vast proven reserves were not jurisdictional sales under the NGA.

The Fifth Circuit's decision is contrary to the teachings of *Rayne Field* because it did not consider the significant economic facts of the PLA transactions that plainly establish that each one of them involved major interstate wholesales of natural gas: (1) PNW relied on the PLA reserves to develop an extensive pipeline system to serve a new three state gas market; (2) the Commission relied on the PLA reserves in certificating PNW's system construction and new gas service;[12] (3) lenders committed $160 million to finance the construction of the PNW system using the PLA reserves as collateral; (4) during 1954, the year before actual transfer, Phillips, the largest PLA producer, made substantial jurisdictional wellhead sales from the development wells existing on PLA-5; and (5) as soon as the PNW facilities were constructed, large volumes of natural gas began

[12] Section 7(e) of the NGA, 15 U.S.C. § 717f(e), provides, inter alia, that "a certificate shall be issued to any qualified applicant therefor authorizing the . . . service [or] construction . . . covered by the application, if it is found that the applicant is able and willing properly to do the acts and perform the service proposed . . . ." Thus, the certificate issued to PNW reflected the Commission's conclusion that PNW had sufficient readily available gas supplies to "properly . . . perform" the interstate transmission of natural gas to the Pacific Northwest market.

flowing from the PLA reserves into interstate commerce to the gas consumers of the Pacific Northwest.[13]

The court of appeals' decision exempts from regulation a large and important category of wholesales for resale in interstate commerce which under *Phillips* and *Rayne Field* must be regulated. If western gas consumers are to be afforded the protection against exploitation to which they are entitled under the NGA, the decision must be reversed.

THE DECISION BELOW ILLOGICALLY DEPARTS FROM PRIOR PRECEDENT HOLDING THAT EXTENSIVE DEVELOPMENT DRILLING IS NOT REQUIRED FOR COMMISSION JURISDICTION TO ATTACH TO A LEASE-SALE TRANSFER.

Rayne Field involved a sale of leases in a proven field on which a substantial number of development wells had been drilled by the producer prior to transfer.[14] The

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[13] The court of appeals' disregard of the economic realities is contrary not only to **Rayne Field** but also to other leading cases in the courts of appeals. **See Louisiana Land & Exploration Co. v. FERC, 574 F.2d 204, 207 (5th Cir. 1978), cert. denied, 439 U.S. 1127 (1979)** ("economic realities . . . determine whether a jurisdictional sale has occurred."); **Mobil Oil Corp. v. FPC, 463 F.2d 256, 262 (D.C. Cir.), cert. denied, 406 U.S. 976 (1972); Continental Oil Co. v. FPC, 370 F.2d 57, 66 (5th Cir. 1966), cert. denied, 388 U.S. 910 (1967).**

[14] The Rayne Field producers did substantial development drilling in the belief they were going to sell their gas by wellhead sale. After performing this drilling they restructured the transaction to a lease-sale in order to avoid jurisdiction. The San Juan Basin producers selected the lease-sale form after they had drilled sufficient wells to prove their reserves but before they had performed much development drilling. This distinction has no regulatory significance.

court of appeals erroneously read *Rayne Field* to require similar substantial pre-agreement development drilling before a lease-sale could be jurisdictional. That conclusion is wrong as a matter of long standing precedent, sound policy and economic reality.

After *Rayne Field*, the leading case governing the jurisdictional status of lease-sale agreements is *Ship Shoal*.[15] In *Ship Shoal*, the Fifth Circuit confronted a lease-sale involving acreage upon which there had been no development drilling at all prior to the transfer of the lease to the pipeline. Only one shut-in gas well with no production history was in the 3,000 acre field at the time of transfer.[16] The producers in *Ship Shoal*, citing *Rayne Field*, similarly argued that the lack of development drilling defeated Commission jurisdiction. Then the Fifth Circuit disagreed:

> It may well be that Ship Shoal is a "long way" from being fully developed. Catco [the producer] anticipated that from 34 to 40 additional completions would be necessary to calculate the final consideration in the seventh year redetermination of reserves. But this problem relates more to determination of final consideration, than to imminent ability for production. The "substantial and determinative economic fact" is that Catco transferred

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[15] **See also FPC v. Pan American Petroleum Corp., ("Bastian Bay"), 381 U.S. 762 (1965), rev'g mem. 339 F.2d 694 (10th Cir. 1964).**

[16] **In holding that the PLA transactions failed to meet a "substantial development" test the court of appeals simply ignored the absence of development wells in Ship Shoal. Had the court faced up to the facts of Ship Shoal, it would have had to admit that the 124 wells on the PLA acreage when the reserves were transferred — the equivalent of one well per every 2,730 acres — represented more development drilling per acre than in Ship Shoal.**

> a large volume of natural gas, definable within a range of reliable engineering estimates, to a jurisdictional pipeline company for imminent interstate transmission.
>
> * * *
>
> The crucial fact here, as in *Rayne*, is that *the assignment of the leases accomplished the transfer of large amounts of substantially proven offshore natural gas reserves to an interstate pipeline company for eventual resale in interstate commerce*. The transaction was a sale of a definable volume of gas, the price of which was geared to the actual volume found, and payment for which was directly related to its production — even if there has also been a transfer of an interest in real property. If such sales were not subject to Commission regulation, an "attractive gap" in the regulatory system would be created, and the producing states would be unable to close it.

370 F.2d at 66-67 (emphasis added).

Significantly, in *Ship Shoal* as in *Rayne Field*, the focus properly was on the economic realities of the lease-sale transactions, substance — not form and certainly not on a mechanical count of development wells in the ground compared to the number of wells required to deplete the acreage.[17] The Fifth Circuit concluded that even though there was no development drilling on the Ship Shoal acreage, the leaseholds had been sufficiently proven and developed for imminent production of natural gas in commercial quantities and thus "had reached the stage

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[17] The court of appeals' use of a "depletion" test is patently impractical and inappropriate. The depletion of a reservoir depends on many factors in addition to the extent of development drilling, including the time allowed for depletion, the reservoir's size and permeability, and state production limitations.

of proof and development necessary to satisfy the *Rayne* criteria." 370 F.2d at 63-64.

The reasoning of the *Ship Shoal* court applies with even greater force to the PLA transfers. PNW, like Tennessee (the pipeline buyer in *Ship Shoal*), demonstrated its faith in the amount of reserves by its willingness to invest large amounts of money and base its application to the Commission for certificate authorization on the transferred reserves. *Id.* at 65. PNW and its investors staked even greater sums and the certificate application for an entirely new pipeline system on the PLA reserves.

Moreover, PNW's readiness to rely on the PLA reserves, like Tennessee's, readiness

> to connect its lines to [the field provided] . . . a strong indication that the field was "substantially developed" at the time of transfer. Tennessee relied heavily on the *Ship Shoal* reserves in support of its 1960-62 applications for expanded pipeline facilities. It was aware that in comparable situations the Commission generally grants authorization on the condition facilities will be constructed and placed in actual operation within one year of certification. *Id.* (footnote omitted).

Here, within sixteen months of transfer, PNW's new 1200-mile pipeline from the San Juan to the Pacific Northwest had been built, the PLA reserves had been connected to the pipeline through development wells on the acreage and large commercial quantities of PLA gas were flowing in interstate commerce to supply the new market. App. 82a.

The decision below irreconcilably conflicts with both the facts and the reasoning in *Ship Shoal*. The court of appeals ignored *Ship Shoal's* holding that jurisdiction does not require developmental drilling where "[t]he crucial fact . . . is that the assignment of the leases accomplished the transfer of large amounts of substantially proven . . . natural gas reserves to an interstate pipeline company for eventual resale in interstate commerce." 370 F.2d at 67.

The court of appeals' inexplicable rejection of its own long standing *Ship Shoal* precedent makes no sense. There is and should be no regulatory significance in the number of development wells existing in a proven field transferred to an interstate pipeline. Just as *Rayne Field* held that the form of the transaction — which is subject to manipulation by the parties — cannot control jurisdictional status, neither should the extent of development drilling determine jurisdiction. That too can vary between lease-sales and be manipulated without affecting the substance of the transaction. Natural gas producers control the extent of development drilling. Whether they are selling gas conventionally or selling their reserves in place, producers generally will not invest in any more development wells than necessary to establish the proven and available nature of their reserves until the reserves can be connected and sold to a pipeline as the reserves are produced. Investing in further development drilling without first obtaining a sales commitment would be an imprudent expenditure. In any event, whether extensive development drilling has taken place as in *Rayne Field* or there is almost a total lack of development drill-

ing as in *Ship Shoal,* when producers transfer definable and proven reserves in place as they did here to interstate pipelines for imminent interstate transmission they are selling gas within the meaning of the NGA.

The court's unprecedented exemption from regulation of these large interstate wholesales by lease-sales — the form of transaction chosen by the San Juan producers over the wellhead sale principally to avoid jurisdiction — in a vast, proven, yet not substantially drilled field reopened the regulatory gap that *Phillips* and the *Rayne Field — Bastian Bay — Ship Shoal* trilogy endeavored to close.

Unless the decision below is reversed, these major producers, who held large, proven and badly needed gas reserves in the San Juan Basin will escape the price regulation they would have been subject to under *Phillips* had they chosen to sell at the wellhead merely by a change in the form of the transaction. That result ignores the economic realities of these transactions, imposes enormous injury on gas consumers, allows the producers an enormous windfall and defeats the policy of the NGA.[18]

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[18] In this case, Amoco, Atlantic Richfield, Mobil and other large San Juan producers seek to avoid federal price regulation under the NGA of the special overriding royalty obligations which burden some 80% of the production under lease-sale transactions that cover more than one-half million acres and are the economic equivalent of conventional regulated sales. If the producers are successful, the royalty obligation will increase the cost of this major interstate gas supply substantially above the federally regulated price for comparable gas.

With a breathtaking inconsistency, a number of these same producers, when confronted with demands by Kansas landowners for computation of the landowner royalty which burdens only 12½%

THE DECISION BELOW COMPOUNDED ITS ERROR BY FOCUSING ON THE NUMBER OF DEVELOPMENT WELLS AT THE TIME THE PLAs WERE CONDITIONALLY EXECUTED, RATHER THAN AT THE TIME THE PROVEN RESERVES WERE ACTUALLY TRANSFERRED.

Even if the number of development wells existing on the PLA acreage were a controlling factor for finding jurisdiction (which it clearly is not), the court further erred in holding that the dates the PLA conditional assignments were first executed are the dates on which well counting is to be performed. No gas, lease or acre-

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[18] **Continued**

of the production, using a market value in excess of the applicable federal ceiling price, **see Matzen v. Cities Services Oil Co.**, 667 P.2d 337 (Kan. 1983), have argued to this Court that landowner royalties must be subject to price controls under the NGA. **See** Petition for Certiorari, **Mobil Oil Corp., et al., v. Batchelder, et al.**, No. 83-1248 (Jan. 27, 1984). In urging this very substantial extension of federal regulatory jurisdiction under the NGA, Amoco, Atlantic Richfield, Mobil and other major producers have reminded this Court that "economic realities . . . determine whether a jurisdictional sale has occurred", Petition for Certiorari, **Mobil Oil Corp. v. Batchelder, supra**, at 15 n. 19, and that "the federal regulatory agency's jurisdiction under the NGA [must be broadly construed] . . . in order to avoid creatng 'an attractive gap' in the federal regulatory scheme . . ." **Id.** at 24 n. 31 (quoting **California v. Lo-Vaca Gathering Co.**, 379 U.S. 366, 370 (1965)).

These admissions by the producers in **Mobil Oil Corp. v. Batchelder, supra**, are flatly inconsistent with their resistance to NGA jurisdiction in this case and with the decision below. Furthermore, the producers' expressed concern in **Batchelder** that the effect of the Kansas decision could impose "the cost of windfall royalty rates . . . on consumers in other states, thereby frustrating the statutory goal of maintaining reasonable gas prices for interstate consumers," Petition for Certiorari, **supra**, at 23, is conspicuously absent here where they are the recipients of an even greater windfall.

age was transferred to PNW until May 1955. The execution of the initial documents in 1952 and 1953 served only to commit the reserves *conditionally* to PNW, a company which at that time existed only on paper. Commission certification and PNW's obtaining of financing were explicit conditions precedent to the transfer of the PLA reserves.

May 1955, when all conditions were met and the PLA reserves were finally transferred by lease-sale, not the much earlier conditional commitment dates, is the only significant date for assessing PLA development. A producer making a conventional field sale does not become a seller of gas under the NGA at the time he executes a gas sales contract. Only when the producer actually commences delivery of gas under the contract does he become subject to Commission jurisdiction. *See Tenneco Exploration, Ltd., v. FERC*, 649 F.2d 376, 379-80 (5th Cir. 1981); *cf. California v. Southland Royalty Co.*, 436 U.S. 519 (1978). In analyzing the jurisdictional status of a lease-sale, the focus also must be on the delivery date — *i.e.*, the date the acreage and reserves were transferred — not the option or conditional assignment execution date. Since the jurisdictional issue is whether the lease seller is selling gas rather than merely the "right to explore, develop and market [gas] if exploration is successful," *Mobil Oil Corp. v. FPC*, 463 F.2d 256, 262 (D.C. Cir. 1972), *cert. denied*, 406 U.S. 976 (1972), it is irrational to conduct the analysis at a premature point in time when the lease seller cannot possibly be a jurisdictional seller. The examination must take place "at the time of transfer," *Ship Shoal*, 370 F.2d at

65. Only then can Commission jurisdiction under the NGA attach to the lease seller of in place reserves.[19]

In May 1955, when the reserves were actually transferred to PNW following fulfillment of the PLA financing and certificate conditions, the PLA acreage had been "substantially developed" by the PLA producers. The PLA acreage "at the time of transfer", had more development wells per acre than did the Ship Shoal acreage. Moreover, the proven PLA reserves were capable of imminent commercial production and, in fact, were already being commercially produced. On the date of transfer, there were 124 PLA wells; 75 wells were on PLA-5 alone from which Phillips in 1954 produced and made jurisdictional sales of 1.35 Bcf. Further, during the first year after closing, PLA acreage produced over 12 Bcf of gas for the interstate market and some 30 Bcf during PNW's first full year of operation.[20] These substantial volumes flowing in interstate commerce make it indisputably clear that the PLA reserves were capable of imminent production and substantially developed at the time the PLA producers transferred the reserves. Had

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[19] See also Section 2(22) of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3301(22). In section 2(22) Congress defined the term "deliver" with respect to a first sale of gas under the NGPA to mean "the transfer of title" "in the case of the sale of proven reserves in place . . . ."

[20] In Ship Shoal, the producers estimated that their acreage could produce 73 to 82.3 Bcf in the first four years of production. See 370 F.2d at 66. Production of 30 Bcf in the first year shows that the PLA acreage was at least as "capable of imminent production" as was the Ship Shoal acreage. Production by Phillips in 1954 of 1.35 Bcf from PLA-5 for jurisdictional interstate sale conclusively shows that the reserves were capable of imminent production in 1955 when the acreage was actually transferred.

the PLAs not been "ready for action", *id.*, when the producers finally transferred the reserves, lenders would not have provided the financing for PNW's system, Commission certification would not have become final, and the PLAs — conditional upon these occurrences — would never have closed. The contrary conclusion of the court of appeals is plainly wrong.

CONCLUSION

The court of appeals acknowledged that these lease-sales were the economic equivalent of conventional sales and that they transferred large volumes of proven reserves to jurisdictional pipelines for interstate transmission and resale. But, since development wells sufficient to deplete the reserves had not been drilled by the producers when the lease-sales were executed, the court held that these in place reserve sales were non-jurisdictional because *Rayne Field* presently precludes this "next stage in the evolution of the law." App. 15a. This decision ignores *Phillips'* admonition to broadly construe the scope of Commission jurisdiction under the NGA. It misconstrues *Rayne Field* and ignores *Rayne Field's* declaration that Commission jurisdiction includes lease-sales of proven reserves. Finally, it is inconsistent with *Ship Shoal's* well reasoned conclusion that development drilling is not required for a jurisdictional sale under the NGA when the transfer deals with proven and available reserves of natural gas. The decision must be reversed to provide regulation over one of Northwest's principal domestic gas supplies and to afford western gas consumers the protection against large price overcharges to which they are

entitled under the NGA. The Petition for Writs of Certiorari should be granted.

Respectfully submitted,

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